BEFORE THE
ILLINOIS COMMERCE COMMISSION

In the Matter of	)	
	)	
Association of Communications Enterprises	)	
	)	
v.	)	Docket No. 00-0024
	)	
Ameritech Illinois	)	
	)	
Complaint against enforcement of	)	
Unjust and Anti-Competitive	)	
Termination Penalties in tariffs and	)	
contracts for ValueLink service and for	)	
modification of ValueLink tariffs and	)	
contracts	)	

REPLY BRIEF OF

ASSOCIATION OF COMMUNICATIONS ENTERPRISES

September 15, 2000

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Oral Argument Requested

Public Version (Proprietary Information Listed In Bold)

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v.	)	Docket No. 00-0024
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Complaint against enforcement of Unjust and Anti-Competitive Termination Penalties in tariffs and contracts for ValueLink service and for modification of ValueLink tariffs and contracts	)	

I. INTRODUCTION

In its initial brief in this proceeding, the Association of Communications Enterprises ("ASCENT") showed that the penalties charged by Ameritech for termination of its term commitment tariffs/contracts are excessive. Whether these agreements are viewed as contracts, subject to contract law principles, or as tariffs, subject to the provisions of the Public Utilities Act, they are excessive and should not be enforceable. ASCENT showed that the termination penalty in these agreements is indeed a penalty – so much so that it violates the prohibition in the Uniform Commercial Code against liquidated damages clauses that are penalties rather than a realistic proxy for damages. ASCENT also showed that the termination penalty in these agreements result in rates that are not just and reasonable under the Public Utilities Act.

As evidenced by Ameritech's filing of a new set of tariffs that modify all existing termination penalties, the company has abandoned any pretext that its termination penalties are the result of arms length negotiations. Instead, Ameritech views these provisions the same as it views as any other tariff item: Ameritech can modify them at a moments notice. In this case, the company has chosen to make the penalty less onerous. The logical extension of Ameritech's position, however, is that the company could unilaterally make any change it wishes to its termination penalties, including making them more burdensome. Thus, this is not a contract matter from which this Commission may wish to keep its distance. Instead, it is a matter of tariffed rates. Moreover, it is a tariff matter that has serious competitive implications.

Ameritech's argument boils down to its allegation that ASCENT failed to prove that Ameritech's penalty charges do not bear a reasonable relationship to the company's damages from early termination. Ameritech Brief at 7. Ameritech is ignoring the record in this case. The record contains unrebutted evidence that Ameritech's termination penalties result in the company earning a net income of 100% under its original penalty and 50% under its new penalty[1]. Added to those revenues would be any revenues the company receives from resale or unbundled elements purchased by the new provider of the customer that terminated an Ameritech agreement early. That level of net income far exceeds any income that Ameritech could have received if the customer had retained Ameritech service during the full term of the contract. It is therefore excessive under both contract law and public utility law.

The record also contains unrebutted evidence that ASCENT proposed that the terminating customer return its discount, thus allowing Ameritech to earn the same amount it would have earned absent the execution of long term contracts. Under the staff's proposal, Ameritech could

[1] Ameritech argues that it has made this complaint moot or not ripe by changing its termination penalty. Ameritech Brief at 11. This Commission should not let Ameritech escape the review of its tariffs by modifying them in the middle of a complaint proceeding. This is particularly true when these tariffs can be modified again on one days notice. This case should be brought to its conclusion with a final order that clearly set forth principles that Ameritech must apply to any future tariffs for term commitment services.

also recover an additional nominal amount to account for any expenses from the termination. Ameritech may not like that evidence, but it cannot wish it away as it does in its brief.

II. AMERITECH'S TERMINATION PENALTIES ARE NOT ENFORCABLE UNDER CONTRACT LAW.

Ameritech agrees that its termination penalty must withstand the contract standard that it not be at a level that exceeds Ameritech's losses from early termination. Ameritech Brief at 7. As set forth in Section 356 of the Restatement of Contracts[2] and in 810 ILCS 5/2-718, liquidated damages must be set "at an amount that is reasonable in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty." Much of ASCENT's proof in this proceeding addressed this issue of Ameritech's actual or anticipated loss. Capraro Direct at 7-11 and 15-16, Capraro Reply at 4-12.

There are several phrases in this provision that are important. First, the termination penalty must be reasonable in light of Ameritech's anticipated or actual loss. Second, it must be reasonable in light of the difficulty of proof of loss. In this circumstance, there are two ways to try to prove Ameritech's losses. One is the method chosen by ASCENT. If the customer had not entered into a contract, it would have paid full retail rates. Ameritech's loss from early termination is that the customer has received a discount without taking service for the full term of the agreement. Giving back that discount reimburses Ameritech for its "actual" loss, as required under the Restatement. This method meets both prongs of the Restatement test: it reimburses

[2] Ameritech accuses ASCENT of citing to the incorrect provision of the Restatement in its complaint. Ameritech Brief at 13. Ameritech is wrong because the unconscionable term provisions of Section 208 of the Restatement certainly apply to this proceeding. In any event, although ASCENT's complaint referred to Section 208, in its initial brief, ASCENT also relies

Ameritech for its losses and it is simple to calculate accurately. ASCENT provided all the proof needed to show that Ameritech's termination penalty exceeds this amount. Moreover, ASCENT showed that this type of calculation is exactly the type of calculation used by Ameritech in the termination provisions of some of its other long term contracts. Thus, this is a method that Ameritech has implicitly acknowledged provides it a reasonable compensation for early termination.

What Ameritech is really complaining about in this proceeding is that ASCENT did not provide proof of Ameritech's losses under the method favored by Ameritech. Under that method, Ameritech's anticipated or actual losses from the breech equals some undefined figure that takes into account all anticipated revenues, avoidable costs and incremental expenses. Ameritech Brief at 7, 15-16. As this Commission is well aware, however, calculating Ameritech's avoidable costs and incremental expenses is a devilish task that has consumed vast resources of this Commission. In other words, Ameritech prefers to use a method of calculating its harm from early cancellation in a manner that is impossible to calculate. Under the Restatement, a termination penalty that is based on a measure of damages that is impossible to calculate is not appropriate.

Ameritech's action of changing the termination penalty at its whim shows that such a measure of damages leaves the company with far too much discretion. When ASCENT first filed this case, Ameritech insisted that its losses from early termination equaled 100% of the remaining Minimum Annual Revenue Commitment ("MARC") of the customer. Now, after the hearings have been completed and the hearing examiner has marked the record heard and taken, Ameritech has announced that its losses are really closer to 50% of the remaining MARC. Such

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upon the provision preferred by Ameritech – Section 356 Liquidated Damages and Penalties.

a wide range of "losses" demonstrates the impossibility of their accurate calculation using Ameritech's methodology.

While Ameritech's new 50% figure is certainly a move in the right direction, it still leaves Ameritech with a termination penalty that is excessive. Ameritech admits that it should only recover its net profit. Of course, it must make that admission because courts have repeatedly found that damages assessed for lost profits are to be based on net profits. *Getschow v. Commonwealth Edison Co.*, 111 Ill. App. 3d 522, 534, 67 Ill. Dec. 343, 444 N.E.2d 579 (1982). Does this Commission believe that Ameritech's net profit on these discounted business services equals 50% of its gross revenues? What on earth does Ameritech earn from its undiscounted business rates? Even under the method preferred by Ameritech, its penalty should not result in the company receiving any more than a fair net profit over the remaining life of the agreement. If a small company such as CIMCO can get by with a penalty of 25% (TR. 79), then Ameritech's penalty is obviously still too high. Moreover, it must be remembered that unlike CIMCO, Ameritech rarely loses all revenues when a customer switches to another carrier. Ameritech still recovers its revenues under resale tariffs or unbundled elements tariffs. In fact, because resale rates have been set by this Commission at a level that provides Ameritech with its fair rate of return on equity, it would be appropriate to deny the company any termination fees when a customer leaves for a reseller. Ameritech suffers no losses when customers switch to resellers and only minimal loss of anticipated profit when customers switch to companies that provide service over a combination of their own facilities and unbundled elements purchased from Ameritech.

As noted by the court in *Sterling Freight Lines, Inc. v. Prairie Material Sales, Inc.*, 674 N.E.2d 948 (2nd Dist. 1977), the liquidated damages should not put the non-terminating party "in a better position than it would have occupied had there been no breach of contract." Id. 674 N.E.2d at 951. Yet by recovering 50% of the remaining MARC, Ameritech receives one half of its expected gross revenues without having to incur any expenses of providing service and may also recover an additional profit from providing resale or unbundled elements. By any measure, Ameritech' new and improved penalty is still contrary to contract law.

Finally, Ameritech argues that ASCENT had the burden of proving exactly what losses Ameritech will suffer from early termination and to propose a termination penalty that equals that figure. Ameritech Brief at 7, 14-16. Ameritech has misstated ASCENT's burden under the Restatement. That provision states: "A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty." Section 356 of the Restatement. ASCENT proved that Ameritech's penalty is unreasonably large. It is therefore unenforceable. Period. ASCENT is under no obligation to conduct a cost of service study to determine Ameritech's avoided costs and incremental expenses from an early termination. Once ASCENT showed that Ameritech's termination penalty is unenforceable, ASCENT met its burden of proof under contract law. At that point, Ameritech must prove its actual or anticipated losses from early termination. In fact, Ameritech admits that absent a termination penalty in its agreements, Ameritech must prove "its actual damages from a customer that failed to live up to the term commitment." Ameritech Brief at 16.

Although it was not required to do so, ASCENT undertook the task of suggesting a method of measuring Ameritech's loss from an early termination by proposing a methodology whereby Ameritech would be made whole. If Ameritech wished to propose an alternative methodology that calculated in all expected revenues and avoided costs and incremental expenses, it could have done so. It instead chose to remain silent and complain that ASCENT did not do Ameritech's work for it. Ameritech's gamesmanship should be disregarded by the Commission. The record contains evidence that Ameritech's termination penalty is unenforceable. Nothing more is required. It is a bonus that the record also contains evidence of an easily quantifiable means of calculating a replacement for that penalty.

Finally, ASCENT must address Ameritech's claim that its termination penalty "makes it easier for customers to switch between service providers because it eliminates uncertainty and avoids unnecessary delays and legal expenses." Ameritech Brief at 16. Ameritech's theory only makes sense if the penalty is fair. 17^{th} Century bread thieves in England were not grateful for the knowledge that there was a certainty that they would be put to death without delay and without legal expenses if they were caught. Similarly, Ameritech's customers are not provided a benefit when they are told that they will have to pay a penalty that makes switching carriers prohibitively expensive. Whatever the time or place, no one should be expected to give thanks for the knowledge that they will be subject to a penalty that is far out of proportion to the damage they may cause.

III. AMERITECH'S TERMINATION PENALTY IS NOT JUST AND REASONABLE.

The preceding section of this brief is based on the assumption that the appropriate standard to use in this proceeding is that provided by contract law. If one views the ValueLink agreements signed by customers and Ameritech as contracts, then the foregoing analysis applies. Ameritech's position in this case, however, raises the issue of whether or not the various term commitment "contracts" are indeed contracts. Ameritech states in its brief that its tariff terms overrule any contract terms. According to Ameritech:

Ameritech Illinois' right to collect termination charges depends on whether the

> customer purchased the plan and received its benefits, not whether the Company can find a copy of the service agreement that the customer signed when it first ordered the service. The ValueLink plans are provided under tariffs, and the tariffs do not require signed agreements. While signed service agreements are used as an acknowledgement of the customer's order and to explain the terms of the plan, a signed agreement is not required for enforcement of the customer's rights and obligations under the plan.

Ameritech Brief at 9.

Thus, there is no "contract" between Ameritech and its customers. Ameritech believes that all of the rights and obligations of service are provided in its tariffs. Ameritech acted on this belief when it filed its tariff revising the penalty from 100% of the MARC down to 50% of the MARC. Of course, given Ameritech's view of the primacy of its ValueLink tariffs, there is nothing stopping the Company from changing those tariffs back to 100% of the MARC the day after the Commission issues its order. Ameritech obviously feels that there was no give and take or any semblance of arms length negotiations when customers supposedly agreed to the termination penalty by signing ValueLink contracts.

If contract law does not apply, then what standards should be used in this proceeding? The obvious answer is that Ameritech's tariffs must contain rates that are just and reasonable under 220 ILCS 5/9-101. It would be unjust and unreasonable for Ameritech to receive a 50% margin on its ValueLink tariffs in the event a customer terminates early, plus receive all revenues from resale or unbundled elements used to serve that customer. Yet that is exactly what Ameritech is requesting.

In contrast to Ameritech's proposal, the termination penalty proposed by ASCENT is just and reasonable. Under that penalty, Ameritech would receive the exact revenues it would have received if the customer had never taken service under one of the term discount plans. This Commission has already found that Ameritech's undiscounted retail rates are just and reasonable, so no further proof by ASCENT is required to set the termination penalty at a level that allows Ameritech to receive the same revenues it would have received from those rates. Looked at from another perspective, adoption of ASCENT's proposal would result in Ameritech being in the same position as if a customer paying undiscounted retail rates switched to a CLEC. It would have received revenues from that customer at an undiscounted rate and it may continue to receive revenues associated with that customer's usage if that customer chooses a CLEC that purchases resale services or unbundled elements from Ameritech.

IV. THE COMMISSION SHOULD FIND THAT TERMINATION PENALTIES FOR SERVICES THAT ARE FOUND TO BE NONCOMPETITIVE IN DOCKET 98-0860 ARE NOT ENFORCABLE.

Ameritech argues that the Commission should ignore the fact that it will soon issue an order in Docket 98-0680, which is the Commission docket addressing Ameritech's competitive declarations services that are the subject of some of its ValueLink services. ASCENT argued that the Commission should enter an order in this case finding that it will void any termination penalty for services found to be noncompetitive in that case. Ameritech argues that ASCENT's request is premature and not ripe for decision. Ameritech also complains that ASCENT did not try to submit evidence in this docket on the competitiveness of each and every service that it believes are noncompetitive. Ameritech Brief at 8-9.

ASCENT believes that the approach it took in this proceeding is the most efficient way to proceed. Illinois has a statute that sets forth standards for whether services are competitive or noncompetitive. This proceeding is not the appropriate forum to make such a determination. Such a proceeding, however, is currently reaching its conclusion. Thus, there will soon be an order, based on an extensive record, that will confirm or reject Ameritech's competitive declarations. Rather than require ASCENT or some other party to wait until that order is issued and then file another complaint, the Commission should indicate now that Ameritech's decision to include what turned out to be noncompetitive services in its ValueLink tariffs has had the effect of locking up customers before those customers' services were competitive. Such a ruling would allow the Commission to avoid a duplication of the effort already made by ASCENT in this case and would prevent Ameritech from benefiting from its premature inclusion of those services in its ValueLink agreements.

V. AMERITECH'S PRACTICES OF CHARGING TERMINATION PENALTIES IN THE ABSENCE OF SIGNED CONTRACTS AND WHEN CONTRACTS ARE ASSUMED BY CLECs SHOULD BE FOUND TO BE IMPROPER.

ASCENT's initial brief discussed the fact that Ameritech should not be allowed to charge termination penalties when it is unable to produce a contract. Ameritech's Brief suggests that it will only charge a termination penalty when no contract can be found and the customer denies in good faith that it entered into an agreement with Ameritech. Ameritech Brief at 10. For the reasons set forth in ASCENT's initial brief, Ameritech's proposal is inadequate because it leaves open the possibility that the customer agrees that some sort of an agreement had been reached, but that it was for a shorter period of time or with a smaller MARC, or that the customer was not made aware of the termination penalties. The Commission should therefore accept the proposal of ASCENT that when Ameritech is unable to produce a contract signed by a customer, then it may enforce its termination penalty only if the customer agrees that it signed a contract for the duration claimed by Ameritech and with the MARC claimed by Ameritech. Additionally, the customer must agree that it was informed of the terms of the termination penalty.

Ameritech agrees that it will no longer charge CLECs that assume ValueLink agreements termination penalties in the event that Ameritech wins back the customer. Ameritech Brief at 11. This is one area where ASCENT agrees that Ameritech has made a concession that is satisfactory to ASCENT.

VI. THE COMMISSION SHOULD REJECT AMERITECH'S PROPOSAL TO DEFER ANY DECISION ON THE LEGALITY OF ITS TERMINATION PENALTIES UNTIL THE COMMISSION HOLDS A GENERIC RULEMAKING PROCEEDING.

Ameritech has attempted to avoid a review of its tariff by claiming that any ruling affecting termination provisions should apply to all carriers. Therefore, it wants the Commission to hold a generic rulemaking proceeding to address termination provisions. Ameritech Brief at 17. ASCENT objects to any notion that the Commission should avoid determining the legality of Ameritech's termination penalties until it considers the issue in a generic proceeding. Evidence has been presented in this proceeding that shows that Ameritech's termination penalties are unenforceable under contract law and are not just and reasonable under public utility law. The Commission should therefore issue a ruling based on that evidence. ASCENT notes that Ameritech has made the same argument in *Citizens Utility Board v. Illinois Bell Telephone Company*, Docket 00-0043, which is a current Commission docket investigating the legality of Ameritech's marketing practices. In that case, Ameritech requested that the Commission defer any decision on Ameritech's marketing practices and instead initiate a rulemaking applicable to all carriers' marketing practices. The Hearing Examiner's Proposed Order rejected that argument for the same reason given by ASCENT in this case:"[T]he Commission has already determined, based on evidence and argument presented in this proceeding, that Ameritech's S5 marketing practices are unjust and unreasonable. The Commission cannot permit such practices to continue while we conduct a rulemaking" Docket 00-0043, Hearing Examiner's Proposed Order, September 13, 2000, at 33.

Moreover, a generic proceeding may not be necessary to affect the termination provisions of non-Ameritech carriers. Like any other ruling by this Commission in a complaint case, other carriers beside the parties will pay close attention to the language of the Commission's order and the ultimate direction given to the parties. All of this Commission's orders have implications for nonparties because they provide an indication of how the Commission would rule in future cases with similar sets of facts. This proceeding would be no different. If at some time in the future, the Commission is not satisfied with the termination provisions of carriers other than Ameritech, then it can consider opening a generic proceeding.

Finally, the underlying premise of Ameritech's request is faulty. Ameritech assumes that all carriers should be treated similarly in all matters. That is not true. This Commission has acknowledged that, while all carriers should generally be treated the same, different regulatory policies for CLECs and ILECs are often appropriate:

> This does not mean that regulatory distinctions between incumbent and new LECs never will be drawn. Illinois Bell correctly notes that the new LECs occupy a very new and different place in the industry structure. The new LECs differ in terms of market power, history, service obligations, network responsibilities and many other factors. Creating the regulatory policies which appropriately integrate this new category of service provider into the public switched telephone network will pose challenging questions for many years.[3]

This issue presents a situation in which disparate regulatory treatment is appropriate. Ameritech is the incumbent carrier that dominates the market for business services. A huge percentage of those business customers are locked up by Ameritech's long term contracts with their large termination penalties. Ameritech admitted that **$ PROPRIETARY** of its total

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[3] *Illinois Bell Telephone Company, Proposed Introduction of a Trial of Ameritech's Customers*

business revenues of **$ PROPRIETARY (PROPRIETARY %)** are from customers that receive service under one of its ValueLink tariffs. The percentage of Ameritech revenue that is from customers that are locked into agreements with Ameritech may be even larger, because Ameritech's witness presumed that some of the customers without ValueLink services may be receiving service on an individual contract basis. Tr. 103-4. Because of the level of the termination penalties in those tariffs, those customers are effectively removed from the competitive marketplace. Thus, Ameritech's termination penalties have serious competitive implications. Deferring any decision on the appropriateness of Ameritech's penalties until the conclusion of a rulemaking that has not yet begun would allow that company to keep those customers from enjoying the benefits of the competitive marketplace and would deny CLECs the ability to compete for a significant percentage of Ameritech's customers.

This Commission has evidence before it that Ameritech's contracts are not enforceable and its tariffs are not just and reasonable. It should issue a ruling making findings based on that evidence and then at some later date decide if additional regulatory action is needed for other carriers' termination provisions.

First Plan in Illinois, Commission Docket No. 94-0096 (Order April 7, 1995) Slip Op. at 152-3.

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Respectfully submitted,

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